Docket No. RM01-12-000

BEFORE THE FEDERAL ENERGY REGULATORY COMMISSION

TESTIMONY OF ROBERT B. NELSON, COMMISSIONER
MICHIGAN PUBLIC SERVICE COMMISSION

NOVEMBER 19, 2002

I want to thank the Commission for allowing me to testify today on an issue that affects not only the state public utility commission I represent, but also the ability of the electric industry in general to develop the infrastructure necessary for a reliable transmission system in this country. As the Commission indicated in the Notice of Proposed Rulemaking on Standard Market Design ("SMD NOPR"), a resource adequacy requirement is necessary to ensure such development because new resources take years to develop and spot market prices may not signal the need for new resources in time to avert a shortage. My comments will address the questions related to resource adequacy that were identified in the Commission's Notice of Technical Conference issued on October 22, 2002 that are critical to the interests of Michigan ratepayers.

I. Accommodating differences in state requirements for reserve margins, resource adequacy, and retail access to achieve a standard of seamless resource adequacy within each region

There is no question that differences among states in reserve margins, resource adequacy requirements and the existence of retail access programs dramatically affect the ability to create a regional resource adequacy requirement. It is not only possible, but necessary, to accommodate these differences in connection with the creation of an overall resource adequacy requirement for each ITP in consultation with the Regional State Advisory Committee (RSAC). Differing state requirements for resource adequacy and reserve margins can be accommodated in both states with retail access programs and those without such programs. Even states with rigorous resource planning requirements and no retail access programs can continue to administer those

requirements without contravening the regional resource adequacy requirements envisioned by the SMD NOPR.

States with reserve margins mandated by their commissions or legislatures that exceed the 12% minimum reserve margin proposed by the NOPR should be allowed to follow their mandates. The Commission should take steps to ensure that the load located in a state would be responsible for any additional costs that would be required to sustain a resource adequacy level in excess of 12%. States without mandates may be free to adapt to the resource adequacy requirements of the NOPR; however, the Commission needs to provide incentives for all load to contribute to resource adequacy. If, in the aggregate, the contributions to regional resource adequacy do not provide a requisite level of reliability, the Commission will need to explore further actions to prevent such an outcome.

II. Designing appropriate elements for resource adequacy requirements in areas that have retail access

The fact that the NOPR would require all LSEs to achieve a 12% reserve margin would enhance Michigan's ability to create a workable retail access program. Michigan utilities have maintained a 15% reserve margin in the past. However, the "Customer Choice and Electric Act" ("Act 141") enacted in 2000 creates entities known as Alternative Electric Suppliers ("AESs"). In this respect, the various AESs may not maintain adequate reserves. Therefore, Michigan supports the imposition of reserve margin requirements on all LSEs, which in Michigan would include AESs, subject to consideration for phasing in these requirements to avoid it becoming a barrier to entry.

Standards need to be developed for determining whether resources satisfy the resource adequacy requirement. As commercial sources constitute an ever larger share of total resources,

standards will become crucial to achieving the purposes of SMD . NAESB could be assigned this task.

III. Appropriate Penalties

The NOPR proposes to enforce the resource adequacy requirement by: 1) imposing a tariff penalty on a LSE that takes energy from the spot market during a shortage in a year for which it fails to meet its requirement, and 2) requiring that the spot market electric service of such a LSE must be curtailed first when the shortage is severe enough. Each mechanism would occur at the end of the planning horizon. Michigan supports these measures but prefers a longer planning horizon and penalties closer to the front end of the period. Both will improve reliability without becoming a barrier to entry.

IV. Assigning value to demand-side resource participation in meeting resource adequacy

Michigan shares FERC's belief that it is crucial for the SMD to incorporate demand-side response as a vital mechanism to strengthen competition as well as provide assistance with market power mitigation. As stated in the NOPR, "[T]he ability to bid demand reduction into the spot market in response to supplier prices is still limited and needs to be improved significantly for short-term markets to operate more competitively." We concur and would add that, in addition to full-scale integration into short-term energy markets, demand-side resources must be incorporated into long-term resource adequacy planning as well.

Demand-response resources must be effectively relied upon to moderate energy prices, both in the short-run thorough participation in spot market bidding auctions and in the long-run as a viable resource option to generation and transmission expansion in the regional planning process. In particular, it will be important to establish appropriate mechanisms to evaluate and verify the validity and reliability of demand response resources, so that they can stand on equal

footing with supply and transmission options. Much work needs to be done on this. Likewise, it is important to establish appropriate planning horizon time frames such that all resources, including supply, transmission, and demand resources can compete on a level playing field. And, certainly most critical to successful regional planning is the need to develop and nurture effective regional planning institutions to accommodate regional interests and needs. If regional markets are to develop and flourish, states will be challenged to work together and cooperate in ways that have not been accomplished in the past. Change will not be easy or universally embraced. The potentially huge energy savings and electric grid reliability improvements expected to be generated from establishment of robust competitive wholesale electricity markets, however, are well-worth the effort needed to succeed.